To: Representative Martin Griffin

Fr: Chuck Agerstrand, MEA Retirement Consultant

Date: March 22, 2010

RE: Testimony before OVERSIGHT AND INVESTIGATIONS-HB5953

I will attempt to highlight the primary concerns MEA has with the Governor's Pension Reform Proposals as contained in HB5953.

In the interest of full disclosure I should state for the record that I have never been a big fan of 401(k) plans or as it is referred to in SB 1227/HB 5953 a "defined contribution plan".

Based on my analysis over the past years, Defined benefit plans have traditionally outperformed defined contribution plans by a margin of 2% to 4 % annually. Multiply and compound that 2% to 4% over 30 years and you see a huge disparity in retirement payouts. Most defined contribution plans such as proposed in

SB1227/HB 5953 allows for employee contributions. Past experience has demonstrated that many employees either don't have the discipline or sometimes the means to make voluntary contributions. This can be attributed to a lack of education on the value of investing or the discipline to make contributions for a pension when there may be other pressing financial needs. We can subscribe to philosophy and say the individual can just stew in his or her own choice. Even if you have no 'bleeding heart' for the future misery of retirees, the fact remains that persons living exclusively on Social Security along with a small pensions today aren't getting by, and to some degree, will in the future become subsidized by the general taxpayers.

Another concern is that defined contribution plans or 401(k) are really savings and not retirement plans. A person can withdraw assets from his defined contribution plan under certain financial emergencies, or alternatively once they are eligible to receive their benefits, unwisely spend their savings. We are all destined to experience one or more financial emergencies during our work life. The need or the temptation to withdraw funds may be irresistible and detrimental.

I just don't believe that the provisions contained within SB1227/HB 5953 creating a defined contribution plan or a hybrid pension plan is a good substitute for a defined benefit pension that is currently available to school employees. I am very concerned that current and future generations of school employees here in Michigan will not have an adequate retirement income available to them when they reach retirement.

Moving school employees to a Defined Contribution Plan would have a number of serious policy consequences for school employees. It's difficult to understand why the administration focused solely on devaluing pensions and cutting vision/dental benefits but didn't address the funding of future of retiree health care benefits. The current system of paying for health benefits on a "cash only" basis rather than "prefunding benefits" will create a financial tsunami in future in terms of funding these future benefits. Yet, the pension initiatives contained within SB 1227/HB 5953 ignore this very important problem.

On top of this, SB 1227/HB 5953 proposes to tax school employees to pay more...which is essentially nothing more than a TAX on employee salaries. This tax will provide additional dollars to offset the employers cost for funding these pension plans. Contrary to the press releases from the Governor's office the current defined pension plan is by all standards an inexpensive pension plan. We have seen the cost of this pension program drop from 6.42% of payroll in 2000 to now 3.98%. The increased costs that school districts are paying is primarily a result of an increasing unfunded liability....and I would argue that these costs are a direct byproduct of how poorly the States Bureau of Investments has performed in the investment of plan assets. As an example in 2000 the unfunded charge to local districts was 0.19%. Today that charge is 6.15%. We should investigate further why were not performing better in the investment of plan assets.

When benefit improvements were made in the "Basic Retirement Plan" in the early 1980's that allowed for a cost of living improvement plus a few other enhancements (called the MIP plan), school employees who elected this plan paid for those added benefits through a contribution that approximated 4% salary. School employees who stayed with the "Basic Plan" recognized it would be a non contributory plan and would not include enhanced benefits. SB 1227/HB 5953 is proposing to increase employee contributions further for both MIP plan participants as well as "Basic Plan" participants without any corresponding improvement in pension benefits. If the administration were truly interested in correcting the long term funding issues within this pension program wouldn't you think that they would have proposed to redirect the increased employee contributions into funding future retiree health benefits rather than using these dollars to offset the employers costs to fund these benefits.

So what are we doing to control health care costs? I WOULD SUBMIT NOTHING. All SB 1227/HB 5953 is doing is to shift the burden of mushrooming unfunded liability charges and health care costs to those least able to pay for them. This States record here is replete with decisions by MPSERS is to shift a large portion of the prescription drug costs as well as medical costs to the retirees through increased co pays and deductibles.

My initial reaction to all this cost shifting is that it does nothing to control or reduce future health care costs.

The common excuse for cost-shifting is that when the user has to pay-- health care costs are reduced. This is largely a myth. The U.S. private health care system is a capitalist nightmare. Our health care costs are provider driven, not user driven. The other excuse offered is that local school districts should not be burdened with these increasing costs.

I say again the shifting of costs from employers to employees and retirees does not yield any significant decrease in health care costs. It's apparent we need new solutions to how the State funds retiree health care benefits.

Included within this bill is an attempt to encourage retirements by eligible employees by offering them an incentive to retire. The incentive of 1.6% in my judgment is ill conceived. If fails on two fronts: (1) you don't provide school employees with adequate time to make a life changing decision, forcing them to apply between April 15 and May 15—only 3 weeks away; (2) the proposal lacks a a sufficient financial incentive to stimulate the retirements for those eligible school employees that you wish to have. I know this from my experience in formulating early retirement incentive programs for MEA affiliates and local school districts.

If the State needs to advance a retirement incentive bill that adequately addresses these two issues I would encourage interested parties to take a look at SB 255 or HB 4285 that was introduced by Senator

Kuipers and Representative Miller respectively. In these bills the incentive is 1.75% and contains a window period that affords sufficient time for employees to make their decision.

As more and more Michigan school employees and for that matter retirees are coming to grips with the long-term consequences of the recent and ongoing decimation of their retirement savings accounts during the current economic crisis, the solution for long term retirement security becomes clear—real security requires savings that can't be outlived—the savings that come from a traditional defined benefit pension. States like Michigan and localities have a strong history of providing traditional pension plans to teachers. Retirement security experts agree that a defined benefit plan, coupled with individual savings and Social Security, provides the long-term security that will allow workers to retire independently and with dignity.

Given this evidence, it's unclear how the architects of SB 1227/HB 5953 could come to the mistaken notion that in order to retain effective new teachers, pensions should be replaced with defined contribution accounts and a hybrid pension system. When given the option to choose a primary defined benefit or individual defined contribution account plan, teachers, young and old, overwhelmingly choose the security that comes from a traditional pension.

Teachers need a retirement plan they can depend on after their years of service in our schools. We know defined benefit plans will provide that for them.

To quote a recent Time magazine (October 2009) article on "Why It's Time to Retire the 401k" The ugly truth, though, is that the 401(k) is a lousy idea, a financial flop, a rotten repository for our retirement reserves. In the past two years, that has become all too clear. From the end of 2007 to the end of March 2009, the average 401(k) balance fell 31%, according to Fidelity. The accounts have rebounded, along with the rest of the market, but that's little help for those who retired — or were forced to — during the recession. In a system in which one year's gains build on the next, the disaster of 2008 will dent retirement savings long after the recession ends."

"In what must seem like a cruel joke to many, the accounts proved the most dangerous for those closest to retirement. During the market downturn, the 401(k) s of 55-to-65-year-olds lost a quarter more than those of their 35-to-45-year-old colleagues. That's because in your early years, your 401(k)'s growth is driven mostly by contributions. You control your own destiny. But the longer you hold a 401(k), the more market-exposed it becomes. It's a twist that breaks the most basic rule of financial planning."

Let's face it there are a number of issues that this committee should be looking toward answering some of the fundamental questions that this bill raises. They are,

1. Why is there is a lack of actuarial information pertaining the impact that this legislation will have on the systems current unfunded liabilities; and

2. What is the impact this legislation will have on the contribution requirements that school districts will have to pay in order to provide for two pension plans, the current defined benefit plan and a hybrid plan in addition to funding the health insurance benefits and to pay for the unfunded liability.

3. Finally, there is no study that is offered that portrays the diminution of benefits for future retirees under the proposed defined contribution plan.

I would propose the following points when contemplating what can be done with the Governor's bills.

1. Switching to a defined contribution plan won't save money in the short-term, and any potential long-term savings are uncertain and possibly insignificant.
2. Abandoning traditional pension benefits will impede the ability of the state and other public employers to retain long-term and career employees.
3. Efforts in other states to replace traditional pensions with "defined contribution plans" have proven to be largely unsuccessful, chiefly because asset accumulations in most retirement accounts were insufficient to provide an adequate level of retirement income.
4. The State enjoys significant economic benefits from the pensions paid to state, local, and higher education retirees and to retired public school teachers. Because the benefits are pre-funded, annual benefit payments far exceed annual contributions.
5. Public school employees, including state employees, would experience diminished retirement financial security, contributing to an already-gloomy financial future projected for a large percentage of working Americans.
6. By pooling risks, reducing administrative and investment costs, and retaining a higher percentage of retirement savings in retirement funds, traditional pensions are a more cost-effective means for delivering retirement benefits. By contrast, defined contribution plan administrative costs are higher, and a greater percentage of their assets leave the system before retirement.
7. Given the poor track record of defined contribution plans in providing an assured source of retirement income, removing traditional pension benefits would expose public school employees to a real chance of destitution in retirement.
8. Because traditional pension plans enable participants to retire on the basis of age and years of service, they also enable employers to facilitate an orderly turnover of workers.
9. Women occupy of majority of the school employment positions in Michigan and have breaks in service to utilize child care leaves. This bill will prevent school employees from purchasing maternity and child care leave credit or other forms of service credit to make up for breaks in service. We think this is wrong.
10. A fair analysis of how best to achieve public policy objectives, including how to enable employers to attract and retain qualified school employees, how to compensate them, how to promote retirement security for public employees in a cost-effective manner, among others, inevitably will point to some form of traditional pension plan as a core component of public employee compensation. The current MPSERS plan provides the economic security school employees are relying on.

It is for all these reasons that MEA does not support HB 5953.